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Yen Hits New High

The event was a long time coming, but the yen finally has established a new high against the dollar. On several occasions beginning in early 1988 the Japanese currency had threatened the ¥120 barrier, only to fall back. But on September 28 it finally broke through, beating the old record of ¥120.45=$1.00 set on January 4, 1988, to close at ¥119.65. On the following day the yen went still higher, closing at ¥119.2 in New York, the highest value to date for the yen in the postwar era. As such, the value of the Japanese currency was more than three times the fixed rate of ¥360=$1.00 that prevailed between 1949 and 1971.

Officials on both sides of the Pacific are likely to welcome the yen's strength as a means of reducing Japan's growing trade and current account surpluses on both a bilateral and a worldwide level. A more valuable yen, the argument goes, induces Japanese companies to raise their dollar-denominated prices, thereby leading to smaller sales volumes and lower export values. Skeptics note that this argument seemed to work better in theory than in practice during the 1985-1988 run-up in the yen's value. Although the Japanese currency virtually doubled in value against the dollar during that period, Japan's big trade surplus barely budged, or so it seemed. Those backing this theory are likely to question whether events will unfold any differently this time, even if, as some experts have argued, the yen were to quickly reach ¥110 to the dollar or even higher.

Current evidence suggests that a strong yen over a sustained period would surprise the skeptics with its effect on Japan's external accounts. This conclusion derives in part from the fact that the previous round of yen appreciation did have a large effect on the current account, as the Table illustrates. After peaking at 4.2 percent of Japan's gross national product in 1986, the nation's overseas account (which is equal to the current account) had dropped 71.4 percent on this basis by 1990. Last year's rise returned this ratio to half the level of 1986. (Dollar-denominated imbalances show a different pattern, a result of using a shrinking yardstick. For descriptions of various trade measures, see *JEI Report* No. 15A, April 19, 1991.)

Financial Deficit or Surplus by Sector

(percent of nominal GNP)

	1965-74	1975-84	1985	1986	1987	1988	1989	1990	1991
Nonfinancial Businesses	-7.1%	-2.9%	-1.8%	-1.3%	-2.2%	-4.5%	-6.7%	-9.0%	-6.8%
Households	9.4	10.2	9.7	10.1	7.8	7.4	9.1	9.8	8.4
Public Sector	-2.6	-7.1	-4.1	-4.1	-1.4	0.6	0.6	0.8	0.7
Financial Sector	1.0	0.6	-0.2	-0.5	-0.6	-0.8	-1.0	-0.4	-0.2
Overseas*	-0.7	-0.8	-3.6	-4.2	-3.6	-2.7	-2.0	-1.2	-2.1

*A negative sign indicates that foreign demand for funds exceeds foreign supply, a situation identically equal to a current account surplus.

Source: Bank of Japan

If anything, a substantial appreciation of the yen would have a greater effect now than it did in the 1985-88 period. Those years marked a reversal from the early 1980s, during which the yen arguably had been undervalued against the dollar. Hence, the yen's initial rise vis-a-vis the dollar was absorbed easily, with exporters making relatively small price adjustments in foreign markets. The yen's move to ¥120 and above, however, would occur from a base that already represents substantial appreciation from 1985 levels. And, unlike the previous period, both domestic and export markets are now weak. In 1986, for example, Japan endured a mild recession, but the growing U.S. economy absorbed a large volume of exports. In 1992 not only is the U.S. economy struggling but the Japanese economy itself is suffering through a downturn likely to be worse than the one in 1986. These factors suggest that Japanese companies might act more aggressively than they did previously to maintain short-term profits by raising prices or reducing their presence in foreign markets. Either action would lead to a relatively quick and large downturn in export volume. Hence, the current account surplus would shrink even faster than it did between 1985 and 1988.

But is the yen poised for another significant ascent? The data in the Table suggest that the answer is "no." In 1986 corporate plant and equipment spending was very weak, as evidenced by the fact that nonfinancial businesses absorbed savings equal to a mere 1.3 percent of GNP. During the ensuing boom years the excess demand for funds in the corporate sector rose, peaking at 9 percent of GNP in 1990. The demand for capital at home reduced the supply of yen on international markets, sustaining the yen's appreciation.

In 1991 and this year, however, the corporate financial deficiency has shrunk considerably, corresponding to a rise in the overseas balance to 2.1 percent of GNP in 1991 and an estimated 3 percent in 1992. With corporate plant and equipment spending projected to remain weak in 1993, this trend is not likely to reverse soon. Despite shrunken government surpluses that reduce the supply of

funds available, capital outflows in some form will continue to grow. These arguments suggest that, other factors equal, the supply of yen on international markets is likely to expand, putting downward pressure on the Japanese currency. Not surprisingly, therefore, most experts expect that the yen's trajectory over the next few months is unlikely to be straight up. In fact, there is a fair chance that the Japanese currency could fall back substantially from its recent high.

Douglas Ostrom

Tokyo's "Employment Adjustment" Counters Downturn But Raises Questions

Admitting that the domestic economy is in a deeper rut than predicted, Tokyo has moved to help companies cut labor costs while at the same time ensuring that labor resources are utilized more fully. The central government has turned to a time-tested tool to achieve this aim: the employment insurance system. Even though countercyclical fiscal policy and employment adjustment programs are common in the United States and European countries, Tokyo's past moves to cushion domestic firms from the harsh realities of economic downturns have generated foreign criticism. Whether such criticism is forthcoming during the current recession may depend in large part on which industries Tokyo helps.

On-the-job worker training and retraining long have been important tools used by Japanese management to improve labor productivity. Also important for large companies is the practice of lending underemployed workers to subsidiaries or affiliated companies during slack periods; the lending company continues to cover the entire or a substantial share of the pay of the employee who is on loan. The Human Resources Development Promotion Law of 1969 is aimed at easing the burden of these measures on businesses. Amended in 1985 and 1991 with an eye toward changes in the labor force caused by internationalization, the projected aging of the Japanese population, technological change and expansion of the services industry, the law imposes a tax on all companies equivalent to 0.35 percent of an employee's wages or salary (construction firms pay 0.45 percent) to fund partial government assistance for worker training, employment adjustment and other related programs set up by individual companies. (For details of this and other government programs aimed at helping firms meet changing labor needs see *JEI Report* No. 29A, July 31, 1992.) Through a trade association or similar group a majority of firms in an industry must apply to the government to receive employment adjustment program funds.

On September 29 the Ministry of Labor announced that companies in 10 industries would be eligible for employment adjustment assistance for one year beginning October 1. Included are makers of: plywood, fireproof materials (including bricks), four categories of steel, fabricated steel products, fabricated nonferrous metal products (excluding die-cast), ball and roller bearings, and computer software. The ministry expects another 10 industries to apply for assistance before the end of the current fiscal year next March. The machine tool industry reportedly is polling its members on whether to apply for assistance. The Labor Ministry estimates that the 10 recently approved industries cover 5,100 companies with 476,000 workers and, together with two industries already covered, will bring disbursements for employment adjustment and retraining to as much as ¥2 billion ($16 million at ¥125=$1.00) in FY 1992, several times the previous fiscal year's figure.

Despite the fact that the program is funded by corporate taxes and that the total amount of aid is small, Tokyo's action could arouse foreign ire. With Japan's trade surplus climbing toward a record annual high and foreign economies still mired in recession, any government help to industries that export is an easy target for foreign criticism. During previous economic downturns and periods of economic structural adjustment, Washington warned Tokyo not to soften the blow to domestic companies for fear that such assistance would slow or limit the market-driven adjustment process. With Europe pondering its future as an economic bloc and the United States in the last leg of a